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Industry Frets Over SEC Custody Proposal

A new Securities and Exchange Commission proposal may not necessarily strengthen protections for assets overseen by investment advisers, according to securities lawyers and financial adviser groups.

The SEC proposed Thursday to require investment advisers who hold or have access to customer funds to undergo annual exams to confirm the money actually exists. These changes come in response to massive investment scams by Bernard Madoff and others, and public outcry over lax oversight.

Industry representatives are awaiting the SEC's written, detailed proposal but some say the commission appears to be casting its net unnecessarily wide.

For example, the exam requirement appears to include advisers who have arranged with customers to withdraw their advisory fees directly from accounts held with third-party custodians, instead of having clients write checks when the fee is due, said David Tittsworth, executive director of the Investment Adviser Association, which represents investment advisory firms. This arrangement doesn't give advisers unfettered access to client funds and these advisers shouldn't be subject to the exams, he said.

"Clearly we think that's overly broad," Tittsworth said. "The scope of the proposal, from what we can tell, is much greater than we had expected."

Under current rules, just a small number of investment advisers, such as those who mail statements directly to customers instead of having a third-party custodian send them, are required to undergo audits.

Most investment advisers place client assets with a third-party custodian. Requiring advisers to place assets with a so-called qualified custodian who sends investment account statements directly to clients and who are subject to an annual audit requirement could be a more effective way to ensure the safety of client assets, said Bruce MacKenzie, a partner at Dorsey & Whitney in Minneapolis, who represents investment advisers.

Another part of the SEC proposal - that investment advisers or affiliates who directly hold client assets be subject to review by an accountant registered with the Public Company Accounting Oversight Board - could provide an effective layer of oversight, said Duane Thompson, managing director at the Financial Planning Association, whose members include investment advisers.

Still, the association is concerned about "overkill," which could include audit requirements that are costly but not necessarily effective. These costs will ultimately be passed along to investors, Thompson said.

The SEC's plan could backfire if the agency misses a problem then pursues an investment adviser at a later date, said Jonathan Uretsky, a New York-based securities lawyer who represents investment advisers.

"As a defense attorney, I can use the fact that my client has already been checked out by the SEC if an attorney brings an enforcement action against one of my clients," Uretsky said.

Until the proposals are fleshed out, investment advisers should run their operations as if the SEC could stop by any day, which includes keeping all records in order, he said.

An SEC spokesman declined to comment on the early reaction to its proposed rule amendments. The agency will accept comments on its proposal within 60 days of its publication in the Federal Register.

Source: [The Wall Street Journal](#)